



(RESEARCH ARTICLE)



## Internal Controls: Tool for the company's success

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### Abstract

This project is about analyzing the role and importance of the internal control system over the organization's effectiveness and efficiency. For the research purposes, the impact and the commitment of the control environment are discussed over the following topics: a) corporate governance, b) reporting system, c) fraud risk and other unlawful acts. The research was conducted in developing countries, with a specific focus on Georgia, where the significance of internal controls is a relatively new and emerging concept in the market. The primary research was done by using the qualitative methodology by referring to the purposive sampling. The data obtained through the primary research were analyzed and presented mainly by the frequency tables and pie charts. The study shows that the investment in implementing and/or improving the internal controls are paid off by the creation of the transparent and sound business entity. But there were found a number of areas that need to be considered by the company's management in order to reap all the benefits that could be achieved by creating the effective internal control system.

**Keywords:** Internal controls; Control environment; Corporate governance; Financial reporting, Fraud prevention and detection

### 1. Introduction

This research explores the role of internal control systems in enhancing organizational effectiveness and efficiency. Internal controls include policies, procedures, and audits designed to ensure smooth operations, compliance with laws, and safeguarding assets (Hamed Arad et al., 2009). Effective controls support accurate financial reporting and ethical operations, balancing cost and benefit (Robert W. Gramling, 1998; The KPMG Review, 1999).

In Georgia, the government has increased focus on financial transparency following the "Association Agreement" with the European Union, leading to the "Law on Accounting, Reporting, and Audit" and the creation of the "Service for Accounting, Reporting, and Auditing Supervision." This regulatory shift highlights the need for robust internal controls to ensure compliance and enhance business transparency.

However, internal control systems are not flawless. Organizations must continuously update their controls to address emerging risks and maintain effectiveness (Laura F. Spira, 2001). This study aims to evaluate the impact of internal controls on corporate governance, financial reporting, and fraud prevention within the Georgian context, addressing how these systems support organizational goals and regulatory compliance.

The research focuses on three key questions: How do internal controls facilitate good corporate governance? How reliable are they for financial reporting and decision-making? What role do they play in preventing or detecting fraud?

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This study is significant due to the growing emphasis on regulatory compliance and transparency, highlighted by past corporate failures and the Sarbanes–Oxley Act (2002). The findings will contribute to understanding how internal controls enhance organizational effectiveness and credibility. However, limitations such as time constraints and access issues affected the breadth of the research.

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## 2. Material and methods

This chapter outlines the design and execution of the research project. It covers the methodology used for primary data collection, including how data was gathered, analyzed, and interpreted. The study aims to explore the impact of internal controls on corporate governance, financial reporting, and fraud prevention, using both primary and secondary data.

The research adopted an inductive approach, focusing on qualitative methods to gain insights from professionals about internal controls. Interviews were conducted using a structured set of questions to gather detailed, relevant opinions. The sample consisted of 147 respondents from various departments, selected through purposive sampling to ensure expertise in internal controls.

Data was collected via a web platform with a mix of close-ended and open-ended questions. The responses were organized, coded, and analyzed using frequency tables and charts, providing qualitative explanations and insights.

Ethical considerations were prioritized, ensuring respondent confidentiality and anonymity throughout the study. This approach supports a comprehensive understanding of internal controls' role in enhancing organizational effectiveness and compliance.

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## 3. Results and discussion

This chapter presents the research results based on fieldwork data collected from respondents. The study aimed to assess the control environment and internal control systems within organizations, focusing on their effectiveness and commitment to corporate governance, reporting, fraud prevention, and legal compliance.

Respondents were selected from departments most critical to the company's corporate governance and transparency, such as procurement and finance, which represent 47% of the sample. These departments are particularly vulnerable to risks like misappropriation and corruption.

The positions of the respondents, including high-level roles such as CFOs and CEOs, and key positions like procurement managers and internal auditors, were examined to determine their exposure to and responsibility for internal controls. The sample also included various industry sectors, with a notable concentration in financial services, reflecting the sector's prominence in Georgia.

Overall, the study captures a diverse range of departments and positions, aiming to provide a comprehensive analysis of internal control systems across different industries.

To assess the internal control systems, the study examined respondents' awareness of written policies and procedures. The majority (82%) confirmed the presence of such documentation, indicating that most companies communicate their internal controls effectively. However, 16% noted that their policies only partially meet objectives, and 2% reported no written policies, suggesting some companies still lack proper control mechanisms.

The research also evaluated the impact of these controls on corporate governance and financial reporting. Most respondents (76%) felt confident about their job responsibilities, indicating effective internal controls. Additionally, 98% reported good communication with line managers, reflecting clear roles and responsibilities. However, only 43% of respondents felt adequately motivated by their company, highlighting a gap between performance goals and employee motivation.

In financial reporting, 76% of respondents were aware of task-related risks, contributing to accurate reporting. Nonetheless, 8% experienced delays due to inter-departmental issues, affecting timely reporting. Positive results were observed in task monitoring, training, and adherence to regulations, although 16% were not informed of regulatory changes.

Regarding fraud prevention, 65% of respondents noted clear segregation of duties, but 35% did not, posing a fraud risk. Job rotation practices were reported by 57% of respondents, with room for improvement in fraud prevention. Most companies have IT security policies and proper authorization procedures, reducing the risk of fraud and other unlawful acts.

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#### 4. Conclusion

This chapter summarizes the findings from both the literature review and primary research on internal control systems.

The literature review emphasizes that internal controls are vital for managing business complexities and regulatory requirements. Frameworks like COSO and legislation such as the Sarbanes-Oxley Act promote transparency and risk management but can also incur additional costs. Effective controls require continuous monitoring and adjustment.

Primary research in Georgia shows increased awareness and implementation of internal controls due to recent reforms. However, challenges remain, including outdated reporting practices, slow adaptation to regulatory changes, and inadequate fraud prevention. Improvements are needed in policy adherence, communication, and fraud detection.

Recommendations for Georgian businesses include investing in education about formal policies, ensuring clear and flexible procedures, aligning goals with motivational strategies, and enhancing fraud prevention through proper segregation of duties and job rotations. Additionally, timely reporting and regulatory compliance should be prioritized.

Overall, while internal controls improve organizational effectiveness and transparency, balancing their costs and benefits is crucial. The study highlights the need for continued enhancement in Georgia's business practices to achieve better corporate governance and financial reporting.

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#### Compliance with ethical standards

##### *Disclosure of conflict of interest*

No conflict of interest to be disclosed.

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